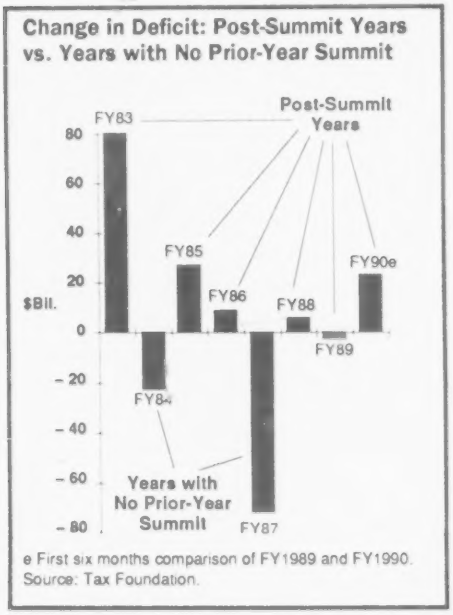
Tax Foundation Vol. 34, No. 6 June 1990

Tax Features

New Paper Traces History of Budget Summits in the '80s

Pattern of Deficit Reduction Shows Negotiations Ineffective

A new Tax Foundation analysis of budget summits during the 1980s entitled *A Decade of Budget Summitry* leaves little room for optimism that the current talks between the President and Congress will lead to deficit reduction. It points out that the FY1991 budget summit is the fifth time in nine years the White House and Congress have conducted special negotiations for this purpose, but the budget deficit has averaged well over $160 billion each year during this period.



e First six months comparison of FY1989 and FY1990.
Source: Tax Foundation.

In the first six months of the current fiscal year, the deficit exceeded $150 billion in spite of a full-year target of $100 billion. In light of these results, summits convened to lower deficits may have done more harm than good.

See Budget Summit on page 5

FRONT BURNER

Budget Process Reform: Two Views

Start from Scratch with a Legislative Overhaul

Cong. Christopher Cox (R-CA)

The nation's budget process has broken down to the point that most Americans, if they understood it, would regard it as a national joke. But it is no laughing matter.

As a freshman congressman, I was struck right away by the utter incomprehensibility of the budget process. Virtually no member of Congress — let alone the public — even reads the huge spending bills we adopt. Moreover, the typical year-end, catch-all spending bill is too long, too complex, and too tardy to expect the President even to read it before he must sign it into law.

On my first day in Congress, then Speaker

Congressman Marty Russo (D-IL)

Honesty Is the Best Budget Policy

When I talk about the budget process, I do so as a member of the Budget Committee who cannot wait to finish serving his last year on it. The budget process is so flawed that it has become a fraud. It is a sham, and one of the most important reasons we have the fiscal woes we do today is that the Budget Committee, along with the Administration and the rest of Congress, has been sliding by the problems for the last nine years.

I hope that as a result of the current budget summit, if nothing else is done, the summiteers will be honest about the problem and honest about the solution. I for one do not

See Russo on page 2, col. 3

Tax Foundation

IN THIS ISSUE

New Analysis of Budget Summits	1
"Front Burner"	1
Tax & Budget Conference	3
President's Message	5
Pittsburgh & Washington Briefings on Budget Issues	6
New Research Fellow	6

Cox from page 1

Jim Wright declared that he was going to violate the law. This may shock most Americans, but in fact it is routine business in Washington. You see, Speaker Wright promised to pass all of that year's spending bills by August. In fact the law requires final action on these bills by June 15th.

Ordinarily it might seem brazen for a newly elected congressman to attempt to refashion what the system has been producing for a long time. But the frustration with the way the budget process has disintegrated is growing to the point that now a fresh approach may be just what is needed.

For that reason, I will soon be introducing a total rewrite of the 1974 Congressional Budget Act. My proposal calls for Congress to enact, on or before May 1, a simplified budget that would fit on one page. This binding "budget law," once passed by Congress and signed by the President, would set legal ceilings on spending in 19 major categories. These are legal limits, not "guidelines"; Congress would not be free to violate them or ignore them when it seemed convenient.

"As a freshman congressman, I was struck right away by the utter incomprehensibility of the budget process. Virtually no member of Congress — let alone the public — even reads the huge spending bills we adopt."

Until that budget is in place, it would be out of order for the House or Senate to consider any spending legislation in subcommittee, committee or on the floor. Once the budget is adopted, Congress could authorize expenditures by majority vote, provided we stayed within the ceilings. To break one of the ceilings, it would take a two-thirds vote. But even then, the President could use enhanced rescission authority — "line item reduction" if you will — to bring these super majority-approved budget busters back down to the totals originally agreed upon by the Congress.

"My proposal calls for Congress to enact, on or before May 1, a simplified budget that would fit on one page. This binding 'budget law,' once passed by Congress and signed by the President, would set legal ceilings on spending in 19 major categories. These are legal limits, not 'guidelines'; Congress would not be free to violate them or ignore them when it seemed convenient."

Finally, if the Congress and the President fail to do anything at all, an automatic continuing resolution would fund the government at last year's levels — thereby insuring we don't face the dilemma of shutting down the government or signing a massive, last-minute, catch all spending bill. The prospect of no change whatever in last year's spending would also provide an enormous incentive for both Republicans and Democrats to get to work on a real budget.

The Gramm-Rudman-Hollings targets were aimed at addressing our gargantuan annual deficits, and they have helped. But they do not go to the heart of the problem, which is an undisciplined, runaway budget process.

It is time to harness this wild animal. My bill will be ready for submission this session. Soon we will discover whether Congress is serious about its responsibilities to the taxpayer, to our economy, and to future generations of Americans.

Christopher Cox, a Republican from California's 40th District, began service in 1989 and is Co-Chairman of the House Republican Research Committee's Budget Reform Task Force.

Russo from page 1

favor any new taxes as a solution to the mounting deficits. I think we can handle them by dealing with the spending side of the ledger, with cuts in both military and non-defense spending.

I think the American public is prepared to make sacrifices if we will tell them once and for all exactly what the problem is and exactly how we intend to solve it. It ought to be a bold approach that will attack the problem over a five year period. The citizens understand that there is a serious problem. Of course, they are very cynical today because every time we need to meet a Gramm-Rudman target, we somehow manufacture a way by asset sales, payday shifts, and faulty assumptions. This is done by both the Administration and the Congress. After we do all that, we say we have met the target. Then as soon as we get into the next fiscal year, CBO comes out with a budget that says we didn't hit the target — the deficit is not really $100 billion — it is really $161 billion. We have been doing that now for the five years that I have been on the Budget Committee. So, either we change the process and get honest, or we ought to get rid of the budget process.

"I for one do not favor any new taxes as a solution to the mounting deficits."

I think the summit is a rare opportunity for the Congress to work with the President — if he is prepared to make the tough decisions necessary to deal with the massive problem. The problem has many components: The economic assumptions are $22 billion off; Medicare and Medicaid costs are going up; there is a shortfall in FDIC premiums; and the cost of food stamps is going up. The Administration knew of these problems before it sent its budget to Congress. But the biggest hit we are going to take is the S&L bailout. That is anywhere between $50 and $100 billion this year alone. So if you take the

Rep. Marty Russo, a Democrat, has served the 3rd District of Illinois since 1975. He serves on the Ways and Means and Budget Committees, and is Deputy Majority Whip.

worst case scenario, the deficit is $186 billion higher than projected. If you take the best case scenario, it is $86 billion off. It depends on how you calculate the numbers.

So the question is, what do we do about it? We just had a meeting with some of our summiteers. Some of us told them that they should be honest, tell us what the problem is, what we need to do, and how we need to do it. And don't come back with payday shifts and other budget gimmicks, the kind of games that have made people in this country cynical about what comes out of Washington.

The Chairman of the Ways and Means Committee has made it very clear that until he has an agreement with the President on what is needed from his committee, he is not going to offer anything and move it through the committee. So, unless and until the President decides he wants revenue as part of his solution and works it out ahead of time, I don't think we will see the Ways and Means Committee moving forward.

"The summit is a rare opportunity for the Congress to work with the President — if he is prepared to make the tough decisions necessary to deal with the massive problem."

Personally, I think you can do it without taxes. It will require a severe hit in the Defense Department, and it will take some hits in the domestic side. For example, one of the things I would recommend we do is eliminate plans for the space station. We don't need to put people out in space when others can't find homes on earth. That can wait. This year we are giving the Defense Department $295 billion in our budget. Last year they got $296 billion. If you can believe David Stockman, there is about $30 – $40 billion of waste in the Defense Department. I will take David Stockman at his word. We need that kind of honesty now if we are to restore sanity to the budget process and prosperity to the nation.

Tax and Budget Conference Brings Government and Industry Leaders Together During Budget Summit

The Tax Foundation held a conference on tax and budget issues in cooperation with Citizens for a Sound Economy Foundation on May 23 in Washington, DC. Corporate executives, members of congressional and executive agency staffs, and of the business press heard presentations from experts in the fields of state taxation and tax complexity, as well as more general discussion of public finance from well-known politicians and economists.

Senator Phil Gramm (R-TX) began the conference by pointing out that the federal budget process was never intended to restrain federal spending and that the budget committee in the House was originally structured to prevent its becoming a source of power. The senator said the Gramm-Rudman-Hollings bill was "the only budget reform that was ever aimed at trying to have a real impact on the deficit." As to whether it has been effective, he pointed out several shortcomings and possible improvements, but cited three developments which prove that overall, the legislation has had a positive impact.

"The Gramm-Rudman-Hollings balanced budget bill was the only budget reform that was ever aimed at trying to have a real impact on the deficit."
—Senator Phil Gramm (R-TX)

First, since the law went into effect, the deficit has been reduced in real terms. Second, for twenty years prior to its enactment, federal spending grew an average of 11 percent annually, compared to 3.8 percent after passage. Third and most important, federal government has begun to grow more slowly than the private sector.

The Burden of Tax Complexity

Lee Sheppard, contributing editor of *Tax Notes*, moderated the first panel on the program. It focused on the complexity of tax compliance, featuring Glenn White, Director of Taxes at Dow Chemical; Charles McLure, senior fellow at the Hoover Institution; Bernard Shapiro, National Director of Tax Policy, Price Waterhouse; and Fred Goldberg, Commissioner of the IRS.

Senator Phil Gramm (R-TX), talks with James W. Nethercott (L), Senior Vice President, The Procter & Gamble Company, and a member of the Tax Foundation's Policy Council.

Glenn White started by citing a much-quoted study by the A.D. Little Company showing that in 1983, corporations in the U.S. spent 2.7 billion hours calculating tax liabilities, the normal work product of 1,350,000 people in one year. He decried the Tax Reform Act of 1986 for worsening the situation and gave anecdotal evidence of his own company's travails in trying to deal with the ever more complex code.

Charles McLure picked out a few areas that are sources of complexity — fringe benefits, low income provisions, and anti-shelter provisions like the alternative minimum tax — but pointed out that the only alternative to complexity in these areas is inaccuracy and distortion of economic decision-making. He outlined instead a more fundamental change in corporate taxation which, among many changes, would allow "immediate write-off of all purchases, whether for inventories, intermediate goods, or capital goods." Aside

Briefings in Pittsburgh and Washington Keep Members Attuned to Budget Issues

Senior Tax Foundation staff met Foundation members and other corporate leaders in Pittsburgh for a briefing on the current budget debate. From left to right: Richard Larry, President, Sarah Scaife Foundation; Wayne Gable, President, Tax Foundation; James W. Wirth, Senior Vice President & CFO, Aluminum Company of America; James C. Miller, III, Co-Chairman, Tax Foundation; Robert A. dePalma, Senior Vice President & CFO, Rockwell International; W. Bruce Thomas, Vice Chairman - Administration & CFO, USX Corporation.

Tax Foundation Co-Chairman James Q. Riordan (L) with Lawrence Lindsey, Special Assistant to the President for Domestic Policy Development, during a briefing at the Old Executive Office Building in Washington, DC.

Tax Foundation Vice President Dan Witt (L) exchanges a word with Michael Darby, Under Secretary for Economic Affairs at the Department of Commerce, before a presentation Mr. Darby made to the Tax Foundation's Program Committee.

Anthony Billings Joins Foundation Research Staff

Anthony Billings has joined the Foundation's staff as a senior research fellow. An associate professor of accounting at Wayne State University, Professor Billings' articles have appeared in the *Journal of Accountancy* and numerous other professional journals.

He has studied international tax problems for Dow Corning and 3M, and at the Tax Foundation he will be undertaking a major study of U.S. taxation of American firms doing business abroad.

Tax Features

Tax Features (ISSN 0883-1335) is published by the Tax Foundation which operates as a separate unit of Citizens for a Sound Economy Foundation. Original material is not copyrighted and may be reproduced. Please credit–Tax Foundation.

Co-Chairman ..... James Q. Riordan
Co-Chairman ..... James C. Miller III
President ..... Wayne Gable
Vice President ..... Dan Witt
Director of Fiscal Affairs ..... Paul Merski
Editor ..... William Ahern

Tax Foundation
470 L'Enfant Plaza, S.W.
Suite 7112
Washington, D.C. 20024
202-863-5454

470 L'Enfant Plaza, S.W.
East Building, Suite 7112
Washington, DC 20024
202/863-5454

Nonprofit Org.
U.S. Postage
PAID
Washington, DC
Permit No. 2979

Mr. Ed Kianka
Congressional Info Service
4520 East-West Highway
Bethesda, MD 20814-3389

from the economics of these proposals, McLure stressed the relative ease of their administration.

Bernard Shapiro outlined the major budgetary legislation of the 1980s. He described ERTA's $750 billion tax cut over five years as "clearly too big . . . but the biggest problem was that it was uncoupled with a spending cut." The huge deficits that resulted have played a major role in budgetary and Presidential politics since then.

James Q. Riordan (L), co-chairman of the Tax Foundation and chief executive officer of Bekaert Corporation, talks with Larry Wilson, general tax counsel at Unocal Corporation.

And combined with the repeal of indexing, they have contributed to tax complexity as legislators look for small pockets of revenue in the code. Mr. Shapiro predicted that the budget summit in progress would bring a major tax bill of at least $15 billion in new revenue.

Fred Goldberg asserted the view that much complexity resulted from perceived abuses of the code. He also sees complexity arising from a well-intentioned attempt to be equitable that ends up in a mire of rulings that are attempts to solve individuals' problems. He closed with a warning that although some may view repealing the corporate income tax as a good simplification, revenue issues are everpresent, deficits are real, and revenue-neutral proposals are the ones that get serious consideration.

Gramm-Rudman-Hollings

The theme of the second panel was "Gramm-Rudman-Hollings: Save It or Scrap It?" James C. Miller, III, Co-Chairman of the Tax Foundation, defended Gramm-Rudman on its record, pointing out that when it has been enforced, the deficit has been substantialy reduced.

Congressman Bill Frenzel (R-MN) also spoke in its defense, but both he and Mr. Miller called the sequester a "meat-ax approach" to budgeting that should be avoided.

Henry Aaron, senior fellow at the Brookings Institution, argued against Gramm-Rudman as a mere procedural distraction from the central issue of what and whom should be taxed.

"Fiscal Policy in the 1990s" was the general theme for the luncheon speaker, the Honorable Jim Jones, Chairman of the American Stock Exchange. Mr. Jones reiterated his long-held belief that "the deficit and national debt are the overriding issue this country has to solve if we are going to have good economic conditions for decades and generations to come." In the investment area, he argued for a capital gains differential and would tie that reduction in the rate to a holding period of at least one year to promote longer term investing. Also, he would favor initiatives to even out the debt vs. equity bias in LBOs.

On the spending side, Mr. Jones is pushing investment in human capital — education and retraining. He sees a labor shortage coming and insists we must improve our labor pool. Aside from education, infrastructure improvements and research and development are at the top of his list of spending priorities.

State and Local Taxes

Gordon St. John Gilman, Tax Attorney, Texaco, Inc., moderated the state/local panel, and after pointing out some particular state-level problems he faces in his role as head of the Dallas Chapter of the Tax Executives Institute, he introduced the panelists. They were Duane Parde, Director of the State Legislature and Private Sector Task Force at the American Legislative Exchange Council; Elliott Dubin, an analyst with the Advisory Council on Intergovernmental Relations; and Steven Gold, Director of the Center for the Study of the States at the Rockefeller Institute.

These experts testified to increasing tax burden at the state level. With less federal assistance than in the 1950s and '60s, states have been raising revenue and may continue to do so at a rate higher than the increase in personal income.

"The deficit and national debt are the overriding issue this country has to solve if we are going to have good economic conditions for decades and generations to come."

—Jim Jones, Chairman, American Stock Exchange

The "No New Taxes" Pledge

Two politicians and two budget analysts discussed the current budget crunch and debated the need for new revenues. Marty Russo (D-IL) and Christopher Cox (R-CA) gave two Capitol Hill viewpoints while Norman Ture, President of the Institute for Research on the Economics of Taxation, and Robert Greenstein, Director of the Center for Budget and Policy Priorities, debated the relative importance of the deficit to the economy. The panel was moderated by Paul Gigot, editor, *Wall Street Journal*.

Congressman Bill Frenzel (R-MN) is flanked by Henry Aaron, senior fellow in economics at the Brookings Institution, (L) and James C. Miller III, co-chairman of the Tax Foundation and former director of the Office of Management and Budget.

Budget Summit from page 1

Talk Is Expensive

Throughout the 1980s the White House and Congress have generally been locked in a budgetary stalemate, impeding any significant deficit reductions. The high-level budget talks held in 1982, 1984, 1985, 1987 and 1989 all fell far short of their stated goals.

Ironically, the fiscal years that were not preceded by budget summits actually resulted in the most real deficit reduction (see figure on page 1). For example, in FY1984, the deficit dropped $23 billion when spending growth was held to 5.4 percent — half the rate of revenue growth for that same year. Again with no summit agreement in force, FY1987 spending grew only 1.4 percent and the budget deficit fell a record $71.5 billion. Conversely, the fallout in fiscal years with negotiated deficit reductions was higher taxes and higher deficits.

Historical Overview

The analysis begins by showing how the well-intentioned negotiations of 1982 and 1984 went awry, concluding, "Any plan that promises to balance today's tax hike with tomorrow's spending cuts is unsound. Taxes once enacted into the code are collected, but long-term spending cuts demand constant discipline."

Congress vented its frustration with the deficit by passing the Gramm-Rudman-Hollings law in 1985, but a budget accord reached earlier in the year with the President fared no better than in 1982 and 1984. In fact, the deficit reached an all-time high of $221 billion in 1986.

The October 19 stock market crash and the looming $23 billion in automatic spending cuts under Gramm-Rudman-Hollings were the cue for high-level deficit reduction talks in 1987. After weeks of closed-door negotiations, the 1987 summit emerged with a plan to trim the deficit $76 billion over the next two years. What resulted was a $5.4 billion increase in the deficit in FY1988 and a FY1989 deficit $11 billion over the summit target. Also, the Gramm-Rudman-Hollings deficit targets were rewritten, postponing the promise of a balanced budget from 1991 to 1993.

During the budgetary stalemate in 1989, the President and Congress were forced to contemplate across-the-board spending cuts mandated by Gramm-Rudman's "sequester." The President and Congress substituted budget summitry for the full sequester, however, and the result was $6 billion in new taxes and one-time savings gimmicks designed to hit a $99.4 billion FY1990 deficit target.

The Current Negotiations: Will History Repeat Itself?

In 1990, fears of a slowing economy and possibly $100 billion in across-the-board spending cuts have sparked deficit negotiations between the White House and Congress. Hopefully, these new talks will actually result in lower deficits. Only 10 of the last 62 budgets paid their own way without deficit spending, and in none of the last 21 years has the budget been balanced. Unfortunately, judging by recent budget summit history, a deficit reduction deal could be a bad deal for taxpayers.

Now Available

A new Issue Brief entitled *A Decade of Budget Summitry,* 4pp. $10 + $2 p/h.

PRESIDENT'S MESSAGE

Globalization of Economy Makes U.S. Tax Policy Seem Parochial

Wayne Gable

Muscovites must be getting used to the golden arches of McDonalds on Pushkin Square. Since opening on January 31 of this year, the Moscow McDonalds has done more business than any McDonalds in the world — the nearly 1,000 Soviet employees there are serving up nearly 50,000 meals a day. Canada's Olympia & York has unveiled plans to extend Moscow's international trade center, and Skanska, a Swedish developer, has joined with five Hungarian state agencies in Budapest's first joint venture office development.

The news is filled with such stories of burgeoning investment opportunities abroad: Eastern Europe, Mexico, the Pacific rim, and even the Soviet Union are opening up. In the past decade, the growth in world trade has far outstripped the growth rate in domestic demand for goods and services. So the watchwords are competitiveness and globalization — how will U.S. firms match up head to head with foreign-based companies in the world marketplace? Some pundits are pessimistic, citing high-tech manufacturing prowess in Japan and the proximity of West Germany to Eastern Europe as reasons that companies based there will prosper.

We at the Tax Foundation are urging policymakers in Washington to realize that U.S. tax policy is a critical component of competitiveness, one that can have a dramatic impact on the fortunes of U.S. firms. Tax Foundation members have made clear in a survey taken earlier this year that they want more research done on the taxation of U.S. firms doing business abroad. Consequently, the Tax Foundation's new senior research fellow Dr. Anthony Billings (see page 6) will initiate a multi-year project on the subject, exploring how various tax provisions help or hinder U.S. competitiveness.

We must remember that international competitiveness depends not only on the innovation of U.S. firms but also on their ability to operate abroad without punitive tax laws holding them back. As the record number of Big Macs selling at the Moscow McDonalds reveals, foreigners do want American products. It is up to us to make sure we don't allow an uncompetitive tax policy to prevent American enterprise from taking those products to foreign lands.